Common Arrangements for Gas

Conclusion on High Level Transmission Tariff Structure in Ireland and Northern Ireland

19th December 2008

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1. Background

This is the third paper published as part of the consultation process on transmission tariffs which commenced in May 2008 under the Common Arrangements for Gas (CAG) Tariff workstream. On 26th June 2008 the RAs published a Consultation Paper[1] ("The Consultation Paper") entitled "Transmission Tariff Methodology and Regulation in Ireland and Northern Ireland". This paper examined the options available for the development of harmonised transmission tariffs in Ireland and Northern Ireland. The paper also dealt with issues arising from the effect of the expected decline in utilisation of the ICs in the future. Following on from this the RAs published a "Draft Conclusions Paper" on 18th October 2008[2]. This paper set out the RA's initial conclusions on the overall tariff regime and the preferred asset configuration at the Exit. Further to this, the paper examined the potential solutions for Entry asset configuration and solutions for the treatment of low utilisation on the ICs.

1.1. Structure of this paper

The remainder of this document is set out as follows:

Section 2: Assessment Criteria

Section 3: Summary of Conclusion

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1.2. Common Arrangements for Gas

On 14th February 2008 the RAs signed a Memorandum of Understanding (MoU) which sets out a vision for Common Arrangements for Gas (CAG) in Ireland and Northern Ireland. The latest

[1] CER/08/107
[2] CER/08/207

work plan[3] showing the development of the CAG project is available on the CER and the Utility Regulator websites.

The development of CAG follows the establishment of the Single Electricity Market (SEM) which became operational on 1st November 2007. The SEM is the first cross-jurisdictional electricity market of its kind in Europe and represents a new culture of cooperation in the energy field.

The development of CAG also fits in with current aspirations at the European Union level. The European Commission has put in place a legislative framework within which all member states are working to achieve a Single Gas Market. This Single European Market is designed to bring benefits to all European citizens and contribute to Europe's competitiveness. Both Ireland and Northern Ireland are committed to the development of a Single European Gas Market and the development of CAG demonstrates this and acts as an example for other member states.

[3] CER/08/171

2. Assessment Criteria

In light of the responses received to the last consultation and upon further consideration the RAs have decided that the assessment criteria put forward in the Draft Conclusions Paper are relevant and appropriate. The assessment criteria are;

- Developing the Industry
- Protecting Consumers
- Security of Supply
- Transparent and Practical Regime

For clarity, the Assessment Criteria from the Draft Conclusions Paper are included below.

2.1. Developing the Industry

Both RAs see an important role for developing an economic, efficient and competitive gas industry in their respective jurisdictions. Explicitly the principal objective of the Utility Regulator is to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland. It is more implicit in Ireland where geographic postalisation within the onshore transmission Exit tariff ensures that there is no undue discrimination between different parts of the country. Following the initial consultation it was recognised that this criterion needed to be clarified further as the title could have differing implications for different industry participants. Ideally, the tariff regime should seek a balance between development on the demand and the supply sides. For instance, a tariff regime that greatly encourages the extension of the network could potentially result in inappropriately high tariffs for all customers. At the same time, a tariff that over incentivises exploration may not be appropriate either. We remain of the view that developing the industry is an appropriate criterion but recognise that a balance must be struck when applying it. Finally, the new tariff regime should ideally facilitate competition within the market. This was initially a stand alone criterion but it was felt that the promotion of competition is inherent in the development of the industry and also in the protection of consumers and so was adequately covered elsewhere. The MoU clearly states that an objective of the RAs is to ensure that gas is bought and sold in competitive markets at the wholesale and retail levels and to encourage a “single market” approach.

2.2. Protecting Consumers

Protecting the short- and long-term interests of consumers is an essential criterion for both RAs. Ensuring that prices are as low and stable as possible, while ensuring the long-term viability of the industry, is key to protecting consumers. This is linked to the promotion of competition and the benefits it should bring to customers. This is set against the principle of cost recovery since without cost recovery the consumer may in time, be exposed to a volatile uncertain market in the future. The reduction of price volatility is another important aspect of the protection of consumers. Short to medium term tariff volatility can have some negative impact on consumers and the chosen tariff regime should be mindful of this.

2.3. Security of Supply

The security of gas supply in Ireland and Northern Ireland is a key consideration for the RAs. The RAs are also mindful of the implications on the Security of Supply to the Isle of Man. The tariff regime developed as part of CAG should recognise the importance of security (and diversity) of supply and should provide appropriate incentives for new developers and producers. This is very important as without sufficient security of supply there would be great uncertainty and volatility in the market and gas users may look to source alternative fuels. This would be to the detriment of the gas industry as a whole. A reasonable balance between the benefits of security of supply and the price that consumers pay for such security should be sought. For example, the tariff regime in place should not have a significant impact on a new field developer's decision on whether to develop a new field. In reality it is likely that the taxation regime in the country would be of more importance. We do however; recognise that this may not be the case for storage and LNG. The tariff regime developed from this consultation process should, as a minimum, not unduly disadvantage new gas developments.

2.4. Transparent and Practical Regime

Finally, the tariff regime implemented should be as transparent and practical as possible. The regime should not be overly complex for users of the system. Essentially this means that the transmission tariffs paid by shippers should be transparent and easy to calculate and understand. This is supported at the European Union level where the general consensus is that tariffs should be straight forward and transparent. Another related aspect of this is the ease of implementation of the new regime. Both jurisdictions employ different tariff structures at present so any solution will cause one jurisdiction to move away from the current one. Ease of implementation is one consideration in the criteria. However the degree of difficulty should not deter from selecting the optimal solution.

3. Summary of Conclusion

3.1. Tariff Regime

Following on from responses received to the previous two consultations and upon further consideration the RAs conclude that an Entry Exit tariff regime will be developed in Ireland and Northern Ireland as part of CAG. We have decided to discount a fully postalised regime. All of the respondents to the last consultation agreed with our view that Entry Exit may be the most advantageous at this time (responses are presented in Section 7). Section 4 (and Appendix A & B) sets out the RAs' Conclusions on Entry Exit and Postalisation in more detail. At a high level, Entry Exit has the following advantages which make it a more suitable tariffs solution than Postalisation.

- Alignment to the rest of Europe
- Provides signals for new investment
- Least market impact
- Ease of Implementation; and
- Allows a route for revenue transfer

The views presented here represent the final conclusions of the RAs on these policy issues in light of the analysis we have carried out and the consultation process that started in May 2008. The RAs will now initiate further work on the basis of these conclusions. It should be noted that the CAG process will involve further consultation steps, both via the RAs e.g. formal licence modifications and the departments where legislation is required.

3.2. Asset Configuration

3.2.1. Exit

At the Exit we have concluded that there will be two Exit tariffs, one in Ireland and one in Northern Ireland. This means that there will be no averaging of tariffs between the two jurisdictions i.e. Exit tariffs in both jurisdictions will remain independent of the other. Having two Exit tariffs also allows the two jurisdictions develop the network in different ways and so have different connections policies and strategies.

3.2.2. Entry

At the Entry the RAs are not in a position to make a final conclusion on asset configuration. In the Draft Conclusions Paper a number of considerations were set out around Entry asset configuration and in particular around the combining of the Moffat interconnectors. Following responses received to the consultation, follow up with participants and further analysis we are still considering the most appropriate solution. This will involve further discussions with the relevant stakeholders. Section 5 sets out in greater detail the issues and options under consideration around the treatment of the interconnectors.

3.3. Entry Exit in practice

Within a future CAG market, it is envisaged that gas can be supplied from a number of sources and delivered across both jurisdictions. For example, Northern Ireland consumers would be able to receive gas from Corrib or Irish consumers would be able to source gas from Larne storage. Under these respective scenarios the following Entry Exit tariffs would be paid:

- Corrib Entry and Northern Ireland Exit. It is envisaged that there would be no transit charge for use of the ROI onshore network.
- Larne Entry and Ireland Exit. It is envisaged that there would be no transit charge for use of the Northern Ireland onshore network.

The above scenarios provide an example of gas moving freely between both jurisdictions. Fundamentally however the Entry tariffs used in the above scenarios will be influenced by the marginal price of gas which is determined by imported gas through the interconnectors. The marginal price of gas, known as the Irish Balancing Point (IBP), is made up of the cost of shipping gas to Moffat (the GB NBP) plus the IC Entry tariff.

4. Tariff Design Assessment

The RAs conclude that Entry Exit is the most appropriate tariff regime for Ireland and Northern Ireland in a CAG regime. We have therefore discounted postalisation as a suitable tariff regime solution. A final conclusion on Entry Exit and Postalisation is set out below.

4.1.1. Final Conclusion on Entry Exit

Following analysis and responses received to the two consultations the RAs conclude that Entry Exit is the most appropriate tariffs solution for Ireland and Northern Ireland in a CAG regime.

There are a number of advantages in an Entry Exit regime. Firstly, it should create appropriate incentives for new gas production sources where new entrants can build pipelines cheaper than the marginal gas source, which satisfies the Developing the Industry and Security of Supply criteria.

Entry Exit also allows the ability to retain two Exit tariffs. This avoids the need for any Exit related revenue transfer between the jurisdictions. It also allows a route for any necessary Entry related revenue transfer, should the need arise. This meets the Protecting the Consumers and Transparent and Practical Regime criteria.

The current Third Package proposals would suggest that Entry Exit will be the required tariff regime in EU countries. It is therefore prudent to adopt a Third Package compliant regime now.

We are aware that there are a number of implementation issues associated with Entry Exit. One of the main issues is the handling of the mutualised assets in Northern Ireland. The RAs are mindful of the work that went into the mutualisation and will ensure that the benefits accrued are not lost in CAG.

Therefore, given the above reasoning, the RAs conclude that an Entry Exit tariff methodology is to be implemented as part of CAG. A more complete assessment of Entry Exit is contained in the Appendix A and summarised below.

Entry Exit	
Advantages	**Disadvantages**
Provides Investment Signals	May require the development of a revenue transfer mechanism
Alignment to rest of Europe	Regulated Marginal Entry Point
Least market impact	Tariff Methodology change for Northern Ireland
Allows a route for revenue transfer	

4.1.2. Final Conclusion on Postalisation

The RAs conclude that Postalisation would not be the most appropriate tariff regime under CAG. Although there are number of advantages to postalisation there is a fundamental problem in relation to unwarranted tariff increases in one jurisdiction namely Northern Ireland. Postalisation would therefore fail the Protection of Consumers Criteria in this case. It should be noted that Postalisation does however meet the protection of consumers in other regards as it results in average cost pricing of gas.

Also, implementing a fully postalised regime would eliminate any incentives for new gas production which would fail to meet the Security of Supply criterion. Further to this, the move to a postalised regime would be at odds with the current Third Package proposals.

Therefore, given the above reasoning, the RAs are discounting a fully postalised tariff as a viable option. A more complete assessment of Postalisation is contained in Appendix A and is summarised below.

Postalisation	
Advantages	**Disadvantages**
Least legislative change	Price increases to Northern Ireland
Average cost pricing	Potential reduced or inefficient investment
Reduced financial risk	At odds with Third Package Proposals
	No route for revenue transfer

4.1.3. Assessment against Criteria

The table below summarises Entry Exit and Postalisation against the Assessment Criteria. A more complete version of this is contained in Appendix B.

	Developing the Industry	Protecting Consumers	Security of Supply	Transparent & Practical Regime
Entry Exit	Positive	Mixed	Positive	Positive
Postalisation	Mixed	Mixed	Potentially Poor	Mixed

5. Specific Asset Configuration

5.1. Exit

In the Consultation and Draft Conclusions Paper a number of options were put forward in relation to the configuration of Exit assets. The options put forward were;

- Separate Exits
- Single Exit
- Multiple (more than two) Exits.

Following further analysis and comments received the RAs have concluded that there should be two Exit zones under CAG, one in Ireland and one in Northern Ireland. For the avoidance of doubt, the Northern Ireland Exit tariff includes the South North Pipeline. The arrangements for contributions by ROI customers served directly by the South North pipeline are under consideration by the RAs.

A separate exit zone in Northern Ireland and Ireland means that there will be no averaging of costs between the two jurisdictions as would be seen in a single Exit and so there will be no unnecessary rise in tariffs in one jurisdiction. This satisfies the Protection of Consumers criterion. Having two Exits also allows each jurisdiction to pursue different approaches to extending networks and developing new connections. This allows each jurisdiction the flexibility to adopt suitable seperate connection policies which would satisfy the Developing the Industry criterion. This is not to say that areas of the connections policies will not be harmonised. We do recognise that a single Exit tariff on the island would have advantages for capacity trading etc but we do not feel that this benefit outweighs the disadvantages mentioned above.

5.2. Entry

In the Draft Conclusions Paper the RAs discussed the options around the treatment of the Moffat interconnectors (SNIP and the ICs). In the last paper the RAs discounted a Single Entry point and the remaining decisions focused on whether or not to combine the Moffat assets into one tariff or not. There was no clear consensus from respondents on the issue (see Section 7). We have considered the issue further and have had discussions with the transporters and with a number of respondents. There are a number of issues that must be addressed in the consideration of the Moffat assets. Some of these are set out below.

- The combining of the Moffat interconnectors into a single tariff is effectively a postalisation of the Moffat interconnectors and may therefore result in a tariff increase/decrease on either the ICs or SNIP compared to leaving them separate. Revenue transfer may be required under this asset configuration to ensure that consumers in either jurisdiction are protected.

- As part of the mutualisation of the SNIP pipeline a number of conditions were put in place in relation to the financing of the pipe. The revenue requirement must be repaid every year and any shortfall must be collected from the Northern Ireland customer. In a combined Moffat this would not be straight forward due to the combining of revenue requirements and so a clear process would need to be put in place. Any proposed amendments to the revenue requirement process should not be adverse to supporting financiers.

- There is a transportation agreement in place between PTL and BGN which deals with the gas entering the SNIP from on-land Scotland. This agreement sees PTL book capacity at Moffat on behalf of all shippers in Northern Ireland. In a common Moffat arrangement this would need to be examined as there may be times where the operator would flow more or less gas down SNIP than was booked for operational efficiency reasons.

- It remains unclear whether operational savings of operating the two lines as one are achievable when two tariffs exist on the lines. If the tariffs are different there would be an incentive to book one pipeline over the other and hence all shippers could reasonably be expected to book the cheaper line first. This could create a distortion in the market relating to cost recovery on one pipeline and depending on regulatory treatment could result in a higher marginal price of gas for all users.

- It may be possible to have two tariffs on the pipelines but set them at the same level. This would most likely see one tariff being set higher or lower than it would have been on a stand alone basis. In the early years of CAG, this would be where the SNIP tariff is brought up to the level of ICs. This would result in an over recovery of revenues on the SNIP which could be passed back to the exit tariff. There would remain an issue with currency fluctuation; this may or may not be significant. One solution would be to set the tariffs on a single day and ignore currency movements within the year thereafter. This would also help shield Northern Ireland from the move to a marginal pricing regime.

- The issue of currency risk will arise where there is a common tariff on Moffat. In a combined scenario a common tariff would be in one currency even though the underlying revenue requirements are in different currencies. If there is significant volatility in the exchange rates one asset owner may be better or worse off. The treatment of exposure to currency risk under a combined Moffat scenario requires further analysis.

- Finally, the Draft Conclusions Paper contains a number of other issues associated with the treatment of the Moffat pipelines.

5.2.1. Further Analysis

The RAs remain of the view that a single Entry Point is not appropriate and that all non interconnector entries should be kept separate. In light of the above issues we are not in a position to make a final decision on the treatment of Moffat.

The issues mentioned above highlight the complexities involved in the treatment of the Moffat interconnectors. The RAs will continue to investigate and consider the issues further. This will involve discussions with the transporters. It is envisaged that a further paper on the issues will be published in Quarter 1 2009. In the mean time the RAs welcome interaction and opinion from interested industry participants on the issue.

6. Mitigating the effect of low IC utilisation

The Consultation and Draft Conclusions Papers looked at the impact of decreasing utilisation of the ICs on the marginal price of gas. It was recognised that this was not a consequence of CAG but was being dealt with as part of this process.

The Draft Conclusions Paper examined a number of mitigation proposals put forward by some participants and sought comment on them. These proposals centred on creating a stable tariffing regime on the ICs in the future. In that paper the RAs stated the following;

As stated previously, the need for and the precise level of mitigation is unclear and will depend on future market developments. For the avoidance of doubt though:

- *The extreme "do nothing" scenario mentioned in the Consultation Paper is not an option the RAs would consider or allow to occur*
- *The aim is to design a suitably robust tariff regime at this time that will handle short term troughs in IC utilisation without being overly interventionist*
- *The RAs will intervene to make some adjustment to the manner in which the IC revenues are recovered if we believe the utilisation will fall below a level that would have a significant detrimental effect on the market*
- *Any intervention in the treatment of the ICs will involve a solution where BGN will recover their required revenues from the market and so stranding will not be considered as an option.*

It is recognised by both RAs that the treatment of IC mitigation has a significant impact on both jurisdictions under an Entry Exit regime and cannot remain unanswered indefinitely. The RAs will consider further the issues arising around the mitigation solution but believe that the implementation of any mitigation measures are unlikely as long as IC tariffs are broadly in line with the current level. Further work is planned to consider what levels of IC utilisation might require intervention and the process by which mitigation could be implemented.

7. Responses to Consultation

7.1. Comments received

The RA's received 12 responses to the Draft Conclusions Paper from interested stakeholders. The feedback received has been useful in forming this Draft Conclusions Paper. Responses were received from the following stakeholders.

- AES
- Airtricity
- Bord Gáis Energy Supply
- Bord Gaís Networks
- ESB International
- Phoenix Natural Gas
- PTL
- Shannon LNG
- Shell
- Statoil
- Viridian Power and Energy (VP&E)
- Confidential Response

One respondent has requested that their response to the Consultation be dealt with in confidence and not be published. All of the other responses are published with this paper on the websites.

In the next sections we address the comments received from the Consultation. The responses are dealt with under the broad headings set out in the Draft Conclusions Paper.

7.2. Substantive issues and RA's responses

7.2.1. Proposed Tariff Regime

7.2.1.1. Postalisation

Most respondents agreed with the RAs assessment of a postalised transmission tariff regime. The proposal to fully discount postalisation is accepted and for the most part supported by the respondents. One respondent does however suggest that the RAs await the outcome of the Third Package before making any final decision. PTL has reiterated that the dissolution of the current NI postalised regime will require consent from their controlling creditor. They also state that any new harmonised tariff structure should preserve the key features of the NI postalised system both in the short and long term. Phoenix also questions the timescale of October 2010 for delivering a harmonised transmission tariff considering the significant legislative changes required to facilitate the NI to move away from postalisation.

We welcome the comments from respondents in relation to a postalised transmission tariff. We note the comment from one respondent in relation to waiting for the final outcome of the Third Package but all indications to date suggest that Entry Exit will be the required regime. We would though point out that the compliance at European level is not the only or even principal reason for adopting a Entry Exit regime.

We also note the PTL comment that the move from postalisation to Entry Exit for NI will require consent from creditors. In relation to legislation, the RAs will work with the Departments in both jurisdictions to develop the required legislation.

7.2.1.2. Entry/Exit

All respondents would appear to accept and for the most part support Entry Exit as the appropriate transmission tariffs regime for CAG. VP&E states that an Entry Exit approach, underpinned by a marginal cost philosophy, will result in a more market responsive and network efficient outcome, and is aligned with the European Third Package. Shannon LNG and Statoil believe that an Entry Exit regime should also increase security of energy supply on the island as it will provide a transparent market signal for new gas supply points. Shell are supportive of an entry/exit regime provided that it is developed and administered in a cost reflective manner, adopting uniform principles for all participants and avoiding cross subsidisation.

Phoenix did question the RAs assessment of Entry Exit against the assessment criteria, they also seek further clarification that the development of the all island regime will include the availability of NI to avail of the cheaper indigenous gas sources within Ireland both available now and in the future.

From the responses it would appear that there is sufficient acceptance and support of an Entry Exit regime to warrant its development in the two jurisdictions. We note comments from some parties that neither jurisdiction should be worse off as a result of CAG and support this. We also accept that there may be issues with an Entry Exit regime where the marginal source is guaranteed its revenues at the marginal point and this will be considered carefully (See Section 6) It is the intention of CAG to facilitate cross border flow of gas, and therefore make available indigenous gas sources to both Ireland and Northern Ireland consumers.

7.2.1.3. Treatment of Moffat Interconnectors

There is no clear consensus from respondents in relation to the treatment of the Moffat interconnectors. Airtricity, BGES, BGN and the confidential respondent are in favour of a combined Moffat. The main reasons given for their support were security of supply and operational efficiency. BGN argue that Moffat should be treated as a single capacity product, and by combining the pipelines the prices faced by the shippers reflect the optimum cost of transporting gas from GB irrespective of the actual route taken by the gas. They believe that setting different prices for the two products would simply distort booking and utilisation incentives as shippers would book their capacity first on the cheaper link if the two assets provide an identical link.

Airtricity make the point that a combined Moffat offers substantive benefits which could potentially reduce IBP, maintain some production incentives even if at lower prices and any foreseen disadvantage to the NI customer could be remedied with the design of the Exit tariffs.

ESBI, Phoenix, PTL, Shannon LNG, Shell, Statoil and VP&E favour keeping the ICs and SNIP separate.

VP&E suggest that the bundling of Moffat reduces transparency and therefore works against the general thrust of European policy on cross jurisdictional interconnectors and its drive for increased transmission transparency. Shell believes that any bundling of Moffat would suggest cross sudsidisation which in principle they are not in favour of. Statoil also supports the implementation of separate entry points as it allows for producer margin at lower cost entry points, thus incentivising indigenous gas production and facilitating competition, with consequential benefit to security of supply. Shannon LNG echoes Statoil's point by saying that each entry point should be allowed to compete on the basis of its fundamental economics and allowing the buyers and suppliers of gas to decide which entry point they wish to use. PTL support keeping them separate as they believe that a combined Moffat will not fully resolve IC under utilisation.

As stated earlier, the issue of combining Moffat and its appropriateness is still under review. The RAs note the respondents comments for and against a combined Moffat and will endeavor to examine all possible options before making a final decision. The issues are expanded further in Section 5 and the RAs aim to publish a further paper on the issues in Quarter 1 2009.

7.2.1.4. Exit

All but one respondent agrees with the RAs conclusion on two Exits. These respondents state that having two Exits gives greater discretion to the RAs in connection policy and particularly because it provides a route for effecting revenue transfers.

BGES are still in favour of a single Exit tariff, stating they see no proposed difficulty in relation to revenue transfer. They also point out that it would allow active secondary trading and also succeed in creating a common arrangement. The confidential respondent believes there is merit in the RAs demonstrating in monetary terms the additional benefits to the market of separate exit points compared to the single or multiple exit points options. They do not believe this has been adequately addressed in any publications to date. ESBI also raise the question of which exit point does the SN pipeline sit in and what is the tariff for using it. Phoenix believe any use of the SN pipeline by ROI shippers will require a system to be developed where any revenues generated will be returned to NI for the benefit of NI customers. They propose that having two Exit points will allow for such a methodology.

Exit options are detailed in Section 5.2 of the Draft Conclusions Paper of 17th October 2008 and in Section 5.3 of the Consultation Paper of 27th June 2008. A single Exit would create a tariff increase in one jurisdiction while removing the most straightforward route for revenue transfer and would require the alignment of connection policies in the two areas. This would fail against the Transparent and Practical Regime criterion. The advantage noted by the respondent is that it would allow capacity trading across the whole Island. In the long run portfolio benefits from *capacity trading are averaged out (the more capacity payments "saved" the higher tariffs that result) so the net benefit is questionable.*

Dividing the Island into more than two Exits would be a dramatic move away from the models currently employed by both jurisdictions. This would be detrimental to development of the gas industry especially in more geographically remote regions. It would be detrimental to protection of consumers in these regions resulting in more variable tariffs (changes in demand would have a larger impact). These effects could have an impact on the financial viability of the gas industry in both jurisdictions, the question being how would the financing costs of each zone be assessed and would the riskiness of one zone be carried into the other zones by rating agencies. It is therefore questionable as to whether there would be any additional monetary benefit from multiple Exit zones.

In light of the comments above and further discussion and analysis the RAs are minded to implement two separate Exit tariffs for each jurisdiction. We do note BGES's stance on a single Exit but in the absence of a viable solution to the revenue transfer issue the RAs believe that the arguments against a single Exit tariff outweigh the benefits.

As stated previously the SN pipeline is part of the NI onshore asset base and as such will be dealt with as part of the NI onshore postalised Exit tariff.

Finally, Airtricity suggests that a virtual exit point for gas-fired generation plants in SEM be developed. They believe that this would put all generators in the SEM on a level playing field in terms of bidding in costs to the market.

While the RAs note the Airtricity proposal we believe that it would have the same issues as the single Exit tariff i.e. the averaging of costs and the need for a revenue transfer. Essentially, the two Exit systems have different underlying costs. As part of CAG there will be code developments which will lead to the harmonisation of non annual gas products. It may well be that the tariffs for some of these products will vary by jurisdictions due to different underlying costs.

7.2.1.5. Mitigating the effect of declining interconnector utilisation

BGN and VP&E are in favour of using a cap approach, thereby setting the IC tariff at a specific level and moving any under recovery onto the onshore system. VP&E do ask for further data and a better understanding of all the inputs before they can judge whether the cap level suggested by BGN is the appropriate level and argue that a subsidy type solution should not be introduced without the ability to define a trigger and the flexibility to adjust or unwind the mechanism in the event that market conditions change. They conclude that taking regulatory action to mitigate the effects of under utilisation of the IC's is immensely complex and fraught with risk. BGN and VP&E also support the RAs conclusion that the aim should be to design a suitably robust tariff regime that can handle short term troughs in IC utilisation without being overly interventionist.

We do agree with VP&E's comment that taking regulatory action to mitigate the effect of low IC utilisation is fraught with risk. We do not intend to intervene unless an apparent market distortion is imminent as set out in Section 6.

ESBI felt that the issue of IC utilisation should have formed part of a separate consultation. They believe that Corrib will have a relatively short production plateau and Shannon LNG will only supply a small percentage of the gas requirement of Ireland so the RA's should consider taking no action to deal with this potentially small, potentially short term issue.

We note the ESBI comment in relation to dealing with IC mitigation separately. We have stated from the outset that while the two issues are separate, it is appropriate to deal with them in parallel.

Shannon LNG believe that any IC mitigation proposal should ensure that IC revenue recovery comes from gas flows though the IC's not gas flows through other Entry points or the Exit tariff. Shell and Statoil would appear to generally concur with this sentiment.

While we note these comments we reiterate the position taken in the Draft Conclusions Paper that one of the primary reasons for constructing IC2 was the significant Security of Supply *benefit it provided to all gas consumers. We also reiterate our position that the "Do Nothing" scenario will not be allowed to happen and we will move revenues onshore if the situation warrants it (see Section 6).*

Phoenix believes that there are still too many unknowns to make an informed assessment on the most appropriate methodology to deal with IC mitigation.

The RAs agree that there are a number of unknowns relating to IC mitigation. As discussed in Section 6, both RAs plan to carry out further analysis in order to determine the most appropriate mitigation solution.

PTL are of the view that the Moffat Entry points should not be combined to resolve the IC under utilisation problem. Furthermore, combining Moffat would not fully resolve IC under utilisation, particularly if additional supply points are added to the system. In their opinion cost recovery could be moved to ROI Exit and/or the cost of capital reduced to the lowest available as demonstrated by their mutualisation approach.

While the RAs note PTL's view on combining Moffat, we reiterate the position in the Draft Conclusions Paper that combining Moffat, may provisionally address low levels of utilisation on the ICs as a secondary benefit, it does not remove the IC problem completely. The comments on IC cost recovery are noted and as stated earlier in this paper, further work is planned on determining the appropriate IC mitigation approach.

Airtricity argue the point that IC2 provides Security of Supply and as such its benefit should be carefully assessed, quantified and then levied in such a manner to reduce the tariff implications of IC2 underutilisation. Airtricity stated while they advocate a Security of Supply levy they do not advance it as a singular, or even primary solution. The confidential respondent and BGES believe that intervention should occur before volatility becomes significant and IC tariffs escalate to a level where the gas prices are uncompetitive with alternative fuels. Tariff stability is seen as a key to many respondents.

The RAs agree that tariff stability is a key factor in protecting consumers. Stability would also provide the correct signals to the market in terms of maintaining competition with alternative fuels and providing an attraction to new entrants.

The alternative view that shippers be required to book back-up capacity was rejected by a number of participants, mainly producers. Statoil believes that short term capacity and liquidity at the IBP should allow shippers to manage their own portfolio.

The proposal to require the booking of back up capacity at a different physical pipeline is not being put forward as an IC mitigation solution at this time but may be considered as a Security of Supply measure in the future as part of the Security of Supply workstream.

8. Next Steps

Following on from this Paper the RAs will commence the implementation of the new transmission tariff regime. The proposals presented in this paper represent the final conclusions of the RAs on these policy issues in light of the analysis we have carried out and the consultation process that started in May 2008. The RAs will now initiate further work on the basis of these conclusions. It should be noted that the CAG process will involve further consultation steps, both via the RAs e.g. formal licence modifications and the departments where legislation is required.

We note that there a number of issues that remain unresolved at this time. The key issues amongst these are set out below:

- Specific Entry Asset Configuration
- Capacity Commodity Split
- IC Utilisation Mitigation Solution
- Transmission tariff treatment of storage
- Non Annual Gas Products

The RAs are still actively considering the specific asset configuration and will look to publish a further paper on the issue early in 2009. The issue of the Capacity Commodity split will be examined in the first half of 2009 also. We have already received a number of responses in relation to this and will carefully consider them in our next steps. Also, in order for business models to progress for gas storage projects, the RAs recognise that some direction is required under storage tariffs. This will be examined in the first half of 2009.

An updated workplan will be published on the websites of the RAs in early 2009 which will set out the timeframes for dealing with the next steps in the transmission tariffs workstream.

Appendix A. Assessment of Entry Exit and Postalisation

Postalisation

Northern Ireland currently employs a postalised transmission tariff regime. The regime has been in place since 2004. The success of the regime has been assisted by the fact that until recently Northern Ireland had only one Entry point namely the SNIP. The South North (SN) pipeline was constructed and commissioned recently and now provides a second Entry point (through the interconnector or other Entry points in the South as new sources of production become available). The South North pipeline provides gas to a number of regional towns but will not be flowing any considerable volumes to Northern Ireland until SNIP is full (around 2011).

The implementation of a fully postalised tariff would involve creating a revenue pot with the required revenues from all asset owners (NI Exit, ROI Exit, SNIP, IC1&2, Inch Entry assets, Corrib Entry assets and potentially other new Entry assets). This combined required revenue would then be divided by the total projected flows and capacity bookings to create a single tariff.

Advantages of a fully postalised regime

- Least legislative change

As a postalised tariff is the current structure in Northern Ireland, the move to an all-island postalised tariff would minimise the amount of legislative work required. A "common tariff[4]" i.e. postalised tariff is embedded in primary legislation in Northern Ireland. Any move away from this would require significant legislative change while the extension of a postalised tariff from Northern Ireland to the whole of Ireland would require significantly less legislative change than moving to Entry Exit. In reality though there will be other areas of CAG that will more than likely require some legislative change so the process would be taking place anyway.

- Average cost pricing

Employing a postalised regime will result in an average pricing system where users pay the average price of all the Entry and Exit points rather than paying for all gas at the price of the most expensive Entry point. Adopting an average cost pricing approach through full postalisation addresses the issue of lower IC utilisation. As was noted in the Consultation Paper this results in significant savings (€6,610m) for the two jurisdictions over the "do nothing"

[4] The Energy (Northern Ireland) Order 2003 reference to postalised tariff

scenario. In reality the “do nothing” scenario is an extreme worst case situation but we would expect the savings from this regime to be significant.

- Reduced financial risk

An all-island postalised tariff would increase the size of the overall postalised combined pot and spread the risk across more customers. This ought to be welcomed by financiers as the exposure to risk would be reduced by this larger customer base and the lower risk could be passed onto to customers.

Furthermore, there are two obvious advantages to both jurisdictions operating one postalised tariff; specifically a simplified tariff structure and less volatile prices for consumers. This would on initial examination meet the Transparent and Practical Regime and Protection of Consumers criteria respectively. The transparency and practicality may then be lost in the implementation of any revenue transfer. Northern Ireland currently benefits from these advantages; expanding to an all-island postalised tariff would extend the benefits to Ireland.

Disadvantages of a postalised regime

- Price increases to Northern Ireland

An all-island postalised tariff would lead to a significant increase in transmission tariffs for Northern Ireland consumers. This was shown in the scenarios modelled for the Consultation Paper. Such a resultant situation would be deemed unacceptable and contravene the Protecting Consumers criterion. Therefore, any unwarranted increase in tariffs would need to be offset through a revenue transfer mechanism so that gas consumers in Northern Ireland are no worse off than in the absence of CAG.

Using a single postalised tariff makes revenue transfer more difficult compared to having two Exit tariffs. Therefore with a single postalised tariff, some explicit mechanism would need to be developed which would be external to the set tariff structure. This would be difficult to design and administer as it would be difficult to collect at the distribution level (circa 60% of gas does not enter the distribution system since it is used for electricity generation). Although a realistic counterfactual needs to be established, the increase and consequent revenue transfer may be very difficult to deal with and implement. The design of the counterfactual and implementation of a revenue transfer mechanism would test the Transparent and Practical Regime criterion. Possible means of transferring revenue that could be considered are:

- Governmental transfer, either through a specific grant or via a tax framework. This would require political agreement. Ideally however, the impact should be handled within a tariff structure.

- A reduction to the Northern Ireland distribution network tariff through an increase to the Irish distribution network. However passing transmission costs through to distribution networks may not be an appropriate solution. Also, this approach leaves out power stations as they only pay the transmission element. An additional power station cost would need to be identified.

- Reduced balancing charges for Northern Ireland. Isolating Northern Ireland charges would be difficult to implement within a single balancing zone. Also, balancing charges are relatively small; a significant number of transactions would be required for this to work.

- Reduced connection charges for Northern Ireland (which could act as an incentive to extend the gas network). However the smaller scale of future connection charges would not reflect the sums associated with revenue transfer and would also be unfair to existing customers.

- Rebate to listed Exit points within the Northern Ireland transmission network. This approach would not be available within a postalised regime.

- Rebate applied directly to the bills of customers in Northern Ireland. This approach would bypass the problem of applying the discount through a specific network tariff but could involve numerous entities and intermediate transfers if applied to the final retail tariff.

An all-island postalised tariff would require an administrator function so as to collect and apportion the revenues. This would be similar to the Northern Ireland PSA (Postalised System Administrator) function with the addition of handling currency differences. This is foreseen as a manageable issue. This function could be delivered by the Single TSO or Single Service Provider structures which are being discussed in the operations workstream.

- Potential reduced investment

The implementation of a fully postalised regime in the two jurisdictions does not allow for any producer incentive at a lower cost Entry point. Shannon for example will have a low cost Entry point due to their short length of connecting pipeline. Their lower cost (than the IC for example) Entry point allows them to recoup the difference between their Entry tariff and the higher cost Entry point tariff in the current Irish marginal cost system. This would be especially important to

LNG as they may rely on this extra margin since they have to buy in the gas to sell on. The absence of this margin may deter potentially efficient entry.

The introduction of a fully postalised regime may hamper future investment and would therefore challenge the Development of the Gas Industry and Security of Supply criteria from the supply side.

- At odds with perceived best practice

The move to a fully postalised regime at a European Union level may not constitute perceived best practice. While at present this may make little difference it could have an impact if the Third Package is adopted. As part of the third package it is possible that an Entry Exit tariff may be made mandatory. The latest Third Package drafts[5] seem to be proposing this and consequently it may be prudent to future proof any regime implemented through CAG.

- Potential for inefficient investment

As previously noted, if investment is undertaken, determined by Government policy, or determined by the regulator, there is the risk that over investment will occur, since the market test is missing. This could then push prices up in the medium to long-term.

[5] Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 1775/2005 on conditions for access to the natural gas transmission networks
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2007:0532:FIN:EN:PDF

Entry Exit

Ireland currently employs a separate Entry/postalised Exit regime. At present there are just two Entry points namely the ICs and Inch. Corrib is expected to come onshore in late 2009 with Shannon scheduled to arrive in 2012.

The implementation of an Entry Exit regime in the two jurisdictions would essentially involve Ireland continuing with a regime similar to that in place at present while in Northern Ireland the Entry (SNIP) and the Exit (onshore) would be separated out into different tariffs.

Advantages of both jurisdictions employing an Entry Exit regime

There are a number of obvious advantages to both jurisdictions operating an Entry Exit tariff.

- Provides investment signals for new investment

The implementation of an Entry Exit regime in Ireland and Northern Ireland should create incentives for new investment where a new producer can build a cheaper Entry point and deliver gas cheaper than the marginal Entry point (the issue of IC utilisation may still need to be addressed). As detailed in the table above, this would provide a positive signal under the Development of the Gas Industry and Security of Supply criteria.

- Alignment to the rest of Europe

The introduction of the 3rd Package would appear to consider Entry Exit as the required European tariff methodology. Establishing an Entry Exit tariff regime within CAG could align the single all-island market to future European directives.

- Least market impact

Assuming the issues surrounding IC utilisation and revenue transfer can be resolved; the implementation of Entry Exit may well cause the least impact on the market. In Ireland the move away from Entry Exit may cause some major investments not to go ahead. In reality in Northern Ireland, the structural move from Postalisation to Entry Exit should not have any particularly adverse impact on the market in terms of new investment or development of the industry. Also, it is unlikely to have any effect on the storage model. This would align positively to the Development of the Gas Industry criterion.

- Allows a route for revenue transfer

If revenue transfer is required, an Exit point in each jurisdiction provides a natural transfer mechanism. Currency differences could also be treated via the Exit tariff. This is a significant advantage of this model and would offer a means of protecting Northern Ireland consumers from any unwarranted tariff increases.

Disadvantages of both jurisdictions employing an Entry Exit regime

- Potential price increases

In almost all cases the implementation of Entry Exit leads to a marginal source of gas pricing structure (Single Entry would be the exception). Marginal pricing can be expected to lead to higher prices than an average pricing structure in the short term at least.

- Regulated Marginal Entry Point

In the event of a move to an Entry Exit (marginal pricing) regime in the two jurisdictions, the marginal Entry point will be the regulated BGN IC. One could question whether an Entry Exit regime could work as intended where the marginal Entry point is guaranteed cost recovery at that point. If the market were truly functioning as a market, then to maintain revenues, the marginal Entry point would need to drop its price to compete when a new source comes on stream. This is a fundamental issue and depending on the specific treatment would have an impact across all the proposed criteria.

- Tariff methodology change for Northern Ireland

The move from Postalisation to Entry Exit would constitute a major change to tariff structures in Northern Ireland and as mentioned above would require an amendment to primary legislation. This would most likely require considerable work and resources in Northern Ireland, especially since the regime has operated successfully to date. However within a future all-island market with cross jurisdictional flows, the continued use of postalisation in Northern Ireland could lead to tariff pancaking where shippers in Northern Ireland wish to purchase gas from Corrib or Shannon. Conversely, as Ireland currently operates an Entry Exit tariff, the addition of SNIP and a Northern Ireland Exit point to such a regime would be easier from an implementation perspective.

Appendix B. Consideration of Postalisation and Entry Exit against the Assessment Criteria

Assessment of Postalisation

Criteria	Assessment	Comment
Development of the gas industry	Mixed	Postalisation has different impacts on different areas within the industry. For example, postalisation would result in an average pricing mechanism where the different costs of each Entry and Exit points are averaged out to form a single tariff. This has the effect of averaging out the costs of the different Entry and Exit points and giving a single price which in some cases will be above and in other cases lower than the separate multiple Entry and Exit tariffs. Additionally, implementation of full postalisation would significantly mute the investment signals inherent in prices and so would not satisfy this criterion. For example, should the different jurisdictions have different investment needs this would not be reflected in prices due to the averaging effect. On the demand side it is unclear what the impact of postalisation would be. The averaging effect may result in stimulating demand among customer groups that would otherwise face higher prices. It would however, effectively eliminate any notional balancing point for trading which many would perceive as a disadvantage.
Protection of consumers	Mixed	By introducing average cost pricing postalisation would produce the lowest tariffs for Irish consumers, at least in the short term and also the least volatile tariffs. In contrast however for Northern Ireland consumers, postalisation would introduce a tariff increase and would therefore fail against this specific criterion. On the other hand, if postalisation discourages new market driven investment then there may be questions of the security (and diversity) of the supply of gas to consumers. If investment is undertaken, determined by Government policy, or determined by the regulator, there is the risk that over investment will occur, since the market test is missing. This could then push prices up in the medium to long-term. On the financial side, the move to postalisation should create certainty for financiers through the averaging of costs and spreading the risk across more consumers. A further advantage of postalisation is that it would also absorb price fluctuations by dampening volatility within the transmission tariff.

Security of supply	Potentially poor	As mentioned above postalisation should produce the lowest tariffs for consumers, at least in the short term and also the least volatile tariffs. This would though, come at the expense of market incentives for new infrastructure be it new fields, LNG or storage. This reduced security and diversity of supply may well impact on the market in the long term. It would also make the provision of security of supply more of a regulatory task rather than a market based outcome. In the long run this may make security of supply a defacto obligation for the system operators as the market signals will no longer exist. As stated previously, this lack of market signals may not massively impact the go/no go decision of an off shore field but one could expect it to significantly impact the LNG terminal developers decision on whether they enter the market.
Transparent and Practical Regime	Mixed	Moving to a postalised regime in Ireland and Northern Ireland should provide an easy to understand tariff for shippers on the system. This would not work for the Isle of Man though and a separate tariff would be needed there. Also, the move to a fully postalised methodology would offer the least legislative change to Northern Ireland. From a practical perspective, the calculation of the postalised tariff is, in theory, quite simple. Complicating this, however, would be the implementation of a revenue transfer mechanism between jurisdictions. The level of transparency and cost reflectivity is questionable with a postalised regime. For example, in a postalised regime the shipper paying a tariff at any Entry point will not know exactly what costs their payment correspond to. The same argument would be made by producers with a low cost Entry point where a higher tariff is charged on their gas than if it were a stand alone Entry. This implies a cross subsidisation of other assets. The adoption of Postalisation may not align to future European practice under current Third Package proposals. It would not be practical to revisit setting a tariff methodology again in the near future.

Assessment of Entry Exit

Criteria	Assessment	Comment
Development of the gas industry	Positive	On the supply side it would send signals for new indigenous gas production as well as for any LNG and/or storage facility. Whether the incentives are appropriate depends on the form of Entry Exit regime and whether any IC costs are mitigated. For shippers and suppliers the implementation of Entry Exit would create a single notional balancing point for gas trading. This should create liquidity in the market. Furthermore Entry Exit may provide the least impact to the current market and as such provide stability for future investments.
Protection of consumers	Mixed	In the short run Entry Exit would lead to less stable prices than postalisation. In the long run however, consumers would benefit through its transparent and cost reflective nature and in sending investment signals. An Entry Exit regime does provide a mechanism for revenue transfers should the need arise. This could protect Northern Ireland consumers from any unnecessary increases through tariff harmonisation.
Security of supply	Positive	Through providing the signals for investment an Entry Exit regime should have a positive effect on the security of supply in the two jurisdictions. There is a risk, however, that too much investment is encouraged.
Transparent and Practical Regime	Positive	An Entry Exit regime in Ireland and Northern Ireland would constitute a transparent and practical regime for users of the system and stakeholders alike. The separating of Entry and Exit would also be a practical solution for the Isle of Man as their Exit charges are dealt with separately. An Entry Exit Regime may be the preferred tariff approach under recommendations within the proposed Third Package legislation. It may be practical to align to the proposed approach now rather than revisit again in the near future. This would also give more surety and clarity to the market. A continuation of the Entry Exit regime for Ireland would provide stability and ease implementation issues. Adoption of Entry Exit would however require a complete revision of the NI tariff system and may not be

		as simple to operate as a single postalised tariff. That said, Entry Exit is assessed as having an overall positive effect.